

TEACHERS' RETIREMENT BOARD

REGULAR MEETING

SUBJECT: Update on Federal Legislation

ITEM NUMBER: 7b

ATTACHMENT(S): 1

ACTION:

MEETING DATE: July 13, 2000

INFORMATION: X

PRESENTER: Ed. Derman

SUMMARY

Hogan & Hartson continues to work with CalSTRS staff on a variety of plan administration issues, including the development of the new Defined Benefit Supplement Program. A summary of Hogan & Hartson's comprehensive report for June (Attachment 1) follows.

Elk Hills Compensation:

The House approved funding for the third installment payment, as contained in the Interior Appropriations bill for Fiscal Year (FY) 2001. The Elk Hills payment would be payable to CalSTRS October 1, 2001. With this payment, a total of \$108 million of the approximately \$320 million that is due under the Elk Hills settlement will have been received by CalSTRS. The President, however, already threatened to veto the Interior Appropriations measure over environmental riders, as well as cuts in the President's budget requests on a variety of fronts. The House Interior Appropriations bill cuts \$1.7 billion off the President's FY 2001 budget request.

CalSTRS is also working actively with Senator Dianne Feinstein, the junior-most Democrat on the Senate Interior Appropriations Subcommittee, who is pushing for inclusion of Elk Hills funding. Senator Feinstein has not yet received an indication from Subcommittee Chairman Slade Gorton (R-Wash.) as to whether Elk Hills compensation will be included in the Subcommittee's bill. The general expectation on Capitol Hill is that the Interior Appropriations measure will be vetoed and ultimately negotiated with the President.

Medicare and Proposals for Prescription Drug Coverage (S. 2541):

The House has shown no enthusiasm for moving beyond the issue of prescription drug coverage in the Medicare area. President Clinton, however, is preparing a proposal to provide further relief to health care providers adversely affected by the cuts in Medicare/Medicaid reimbursement payments enacted under the Balanced Budget Act of 1997. The President's proposal would increase Medicare payments to providers by a total of \$21 billion over the next five years.

Senate Finance Committee Chairman Bill Roth (R-Del.) sent members of the Finance Committee a menu of possible options for fundamental Medicare reform, to serve as a basis of discussion among Finance Committee Members in a series of private discussions. There are uncertain prospects for a legislative vehicle and it is unlikely that Medicare relief will become a reality this year.

Pension Portability:

The Chairman of the House Ways and Means Committee is seeking to increase the annual contribution limit for IRAs to \$5,000 and section 401(k) plans to \$15,000. He also wants to include these provisions with portions of the Portman-Cardin pension reform legislation that would facilitate portability among public sector plans (defined benefit, defined contribution, tax-sheltered annuity and deferred compensation). CalSTRS is working with the coalition of national organizations of State and local government groups to persuade the Ways and Means leadership to include these public plan portability provisions in this "retirement security" package.

The Senate version of pension portability was included in the bankruptcy reform legislation and we hope it can be split back off. However, there is no indication by the Senate Finance Committee Chairman Roth, that these pension portability provisions will be put in another pension tax package.

Bankruptcy Reform Legislation Affecting Pensions (H.R. 833):

This legislation would codify at the Federal level protections for a participant's interest in a pension plan in the event of a bankruptcy (includes defined benefit, tax-sheltered annuity and defined contribution plans). Efforts to impose a cap on the amount of a participant's interest that could be protected in these plans have failed. Additionally, provisions have been included to overturn several recent Federal bankruptcy court decisions, which have held that mandatory pension contributions by employees constitute disposable income of a bankrupt participant who is operating under a Chapter 13 repayment plan. This would result in contributions being turned over to creditors instead of being remitted to the plan. House and Senate leaders are in the final stages working out their remaining differences.

Securities and Exchange Commission (SEC) Proposed Pay-to-Play Regulations:

On May 23rd, SEC staff and industry representatives held a roundtable discussion about regulations banning campaign contributions by public pension plan investment advisors to State and local government officials. Last month, the SEC issued a press release praising the Investment Counsel Association of America for their "best practices" approach to the issue, which would essentially bar contributions made for the purpose of procuring work from a pension plan such as CalSTRS. Some SEC staff view this approach as not going far enough and that a mere disclosure standard by itself is insufficient. The SEC continues to explore possible alternative approaches to the flat ban on contributions set forth in its proposed regulations.

Class Action Reform Legislation (S. 353):

The bill would make it easier to remove class action cases from State to Federal court and cap attorney's fees, as specified, if the defendant and at least one of the plaintiffs live in different states. Current law requires that all defendants live in different states from all plaintiffs. The House has passed similar legislation (H.R. 1875). The President, however, is likely to veto the bill.

Mr. Derman will present an update to these activities and any new developments not covered in this report at the meeting.

**MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

Washington Monthly Report

Elk Hills Compensation

We are pleased to report that the full House of Representatives has now passed the Interior Appropriations bill for FY 2001 containing funding for the third installment of compensation due to STRS under the Elk Hills settlement. With this third installment, which would be payable October 1, 2001, STRS would have received \$108 million of the approximately \$320 million that is due to STRS under the Elk Hills settlement.

The House debate over the Interior Appropriations bill was highly partisan and contentious, with the so-called "riders" intended to limit the President's ability to act in the environmental area drawing the harshest criticism. The President already has threatened to veto the Interior Appropriations measure over these environmental riders, as well as cuts in the President's budget requests on a variety of fronts. The House Interior Appropriations bill not only cuts \$1.7 billion off the President's FY 2001 budget request, but is actually \$300 million below last year's spending level.

On the Senate side, we have been working actively with Senator Feinstein, who is the junior-most Democrat on the Senate Interior Appropriations Subcommittee. The Subcommittee has tentatively scheduled a mark-up of the Senate version of the Interior Appropriations measure for the week of June 19. Senator Feinstein has been pushing strongly for inclusion of the Elk Hills funding, but has not yet received an indication from Subcommittee Chairman Slade Gorton (R-Wash.) as to whether Elk Hills compensation will be included in the Subcommittee's bill. In the past, Chairman Gorton has left Elk Hills out of the Senate version in order to have a bargaining chip in the final negotiations with the House in Conference and in the end-of-the-session budget showdown with the Administration. That scenario could very well repeat itself this year, as the general expectation is that the Interior Appropriations measure will be vetoed and ultimately negotiated with the President.

Medicare and Proposals for Prescription Drug Coverage

The issue of prescription drug coverage for seniors continues to resonate with the American electorate and accordingly both parties are scrambling to respond. The competing Democratic and Republican proposals were outlined at length in last month's report.

The latest activity on prescription drug coverage occurred on the House side where, led by our Elk Hills champion Rep. Bill Thomas (R-Bakersfield), who chairs the House Ways and Means Health Subcommittee, the Republicans are so anxious that they held a hearing on the GOP prescription drug bill that had not even been released yet and are going to mark up that bill the following week (the week of June 19). Copies of the legislative language and summary have been provided to STRS staff for their review.

On the Senate side, Senate Finance Committee Chairman Bill Roth (R-Del.) is seeking to consider the prescription drug issue within the broader context of fundamental reform of Medicare. This week, Chairman Roth sent to Members of the Finance Committee a menu of possible options for fundamental Medicare reform, to serve as a basis of discussion among Finance Committee Members in a series of private discussions. (Chairman Roth's menu of possible options has been sent to STRS staff for their review.) Chairman Roth, joined by ranking Committee Democrat Daniel Patrick Moynihan (D-N.Y.), have been seeking to gauge whether it may be possible to forge a bipartisan consensus among Committee Members on broad-scale Medicare. Chairman Roth said this week that if such a consensus can develop, he would be prepared to hold a mark-up of Medicare reform legislation in July.

At this point, the prospects for reaching such a bipartisan consensus on fundamental Medicare reform – even among Senate Finance Committee Members – appear problematic, particularly in this charged election year. In addition, July is likely to be a very hectic month for the Finance Committee, with consideration of several pieces of tax legislation and the high-profile China trade legislation already filling up much of the agenda.

On the House side, the Republican Leadership – faced with protecting their slim five-seat majority – are picking their issues with great care and have shown no enthusiasm for moving beyond the issue of prescription drug coverage in the Medicare area, particularly an issue as politically charged as fundamental Medicare reform.

On a related front, the President is preparing a proposal to provide further relief to health care providers adversely affected by the harsh cuts in Medicare and Medicaid reimbursement payments enacted under the Balanced Budget Act of 1997. The President's proposal would increase Medicare payments to

providers by a total of \$21 billion over the next five years. There was not any immediate GOP reaction to the President's impending proposal.

In the wake of the STRS Board's actions with respect to payment of premiums for Medicare Part A and B coverage for STRS retirees, we are working actively with STRS staff to explore potential Federal legislative options for relief on the matter of the current law penalties that are imposed in the case of a retiree who enrolls in Medicare Part A or B after age 65 as well as possible relief for retirees who have paid Medicare payroll taxes for some period short of 30 quarters in other employment. We expect that Senator Feinstein would be interested in the issue, and the Chairman and ranking minority member of the House Ways and Means Health Subcommittee, Reps. Bill Thomas and Pete Stark (D-Fremont), are both from California. Particularly in light of the uncertain prospects this year for a legislative vehicle broadly addressing Medicare, the prospects for enactment of Federal legislative relief from Medicare penalties or premiums this year would appear to be a long shot at this juncture.

In addition to exploring possible legislative options, we will continue to track Medicare developments on the Hill very closely and keep you informed.

Pension Portability Legislation

The House GOP leadership has settled on a strategy of taking up nearly a tax bill a week, in order to have a series of "message" bills leading up to the GOP national convention at the end of July. Reportedly among the next in line is retirement security. The Chairman of the House Ways and Means Committee is working with Rep. Rob Portman (R-Ohio) on legislation that would increase the annual contribution limit for IRAs to \$5,000 and for section 401(k) plans to \$15,000, along with portions of the Portman-Cardin pension reform legislation.

The Portman-Cardin legislation includes a series of provision that would facilitate portability among public sector defined benefit, defined contribution, section 403(b), and section 457 plans. We have been working with the coalition of national organizations of State and local government groups to persuade the Ways and Means leadership to include these public plan portability provisions in this "retirement security" package. These provisions also have been included in the minimum wage legislation passed by the House and the bankruptcy reform-minimum wage legislation pending before the Senate. The legislative strategy here – akin to the strategy followed some years ago with the section 415 issue – is to try to be included in every pension package that is moving through the Congress. Accordingly, about 20 of the national organizations of State and local groups, including the National Education Association and the American Federation of Teachers, have signed on to a joint letter that was delivered to key House and

Senate Members strongly supporting inclusion of the public plan portability provisions in this retirement security package.

As of now, the Ways and Means legislation is expected to be marked up at the Committee level during the week of July 10, with House Floor action possible the following week.

Over on the Senate side, the pension portability provisions continue to languish as part of the bankruptcy reform legislation that remains in a parliamentary tangle. Senate Finance Committee Chairman Roth, the leading IRA devotee in the Congress, thus far has not indicated an intention to move forward on a separate pension tax package.

Bankruptcy Reform Legislation Affecting Pensions

In addition to the pension tax piece of the bankruptcy reform legislation (H.R. 833), there are a series of bankruptcy-related provisions in that legislation that affect public pension plans. The bankruptcy legislation is in the final stages of an informal conference between House and Senate leaders to iron out the remaining differences.

Reportedly, although final language has not been disclosed, the series of issues that we had been working on with the coalition of State and local groups have been favorably resolved. The legislation includes a provision codifying at the Federal level protections for a participant's interest in a pension plan -- including a governmental defined benefit plan, section 403(b) plan, and section 457 plan -- in the event of a participant's bankruptcy. At the same time, efforts to impose a cap on the amount of a participant's interest that could be protected in a defined benefit, section 403(b), or section 457 plan have failed, and the remaining battle has devolved down to whether a \$1 million cap should be imposed on bankruptcy protection for IRAs. Finally, we have been told that provisions have been included to overturn several recent Federal bankruptcy court decisions which have held that mandatory pension contributions by employees constitute disposable income of a bankrupt participant who is operating under a Chapter 13 repayment plan, and hence must be turned over to creditors instead of being remitted to the plan.

SEC Pay-to-Play Regulations

On May 23, the Securities and Exchange Commission held a roundtable discussion of SEC members, staff, and industry representatives on a series of significant regulatory issues involving investment advisors that included discussion of the SEC's controversial "pay-to-play" regulations that would flatly ban

campaign contributions by public pension plan investment advisors to State and local government officials affiliated with public plans.

As reported last month, the SEC continues to explore possible alternative approaches to the flat ban on contributions set forth in its proposed regulations. Last month, the SEC issued a press release praising the Investment Counsel Association of America (ICAA) for proffering a proposal that would utilize a "best practices" approach to the issue. The thrust of the ICAA proposal is to bar contributions made "for the purpose of" procuring work from the State or local pension plan. However, at the SEC roundtable it became clear that some of the SEC staff view such an "intent" approach as being unduly narrow and unworkable, as well as maintaining that a "best practices" approach does not go far enough and that a mere disclosure standard by itself is insufficient. Reportedly, though, the SEC staff is split among itself over how best to move forward on this issue, and SEC Chairman Arthur Levitt conceded at the SEC roundtable discussion that the pay-to-play issue remains very controversial. Still, the SEC staff reiterated at the roundtable its strong intention to finalize some sort of rule this year on pay-to-play practices in the public plan sector.

In summary, the SEC staff seems to be backing away somewhat from its broad proposed rule, but just how far remains to be seen. No settled "middle ground" appears to be emerging yet, and some observers have characterized the SEC's dangling of the ICAA comments as a mere pretext for the SEC staff to shift direction in its approach, without necessarily embracing the ICAA approach. Meanwhile, a number of the national groups, including the National Association of State Treasurers and the National Governors Association, are continuing to actively oppose the SEC's regulatory efforts in this area.

Class Action Reform Litigation

The Senate Judiciary Committee is tentatively scheduled on June 22 to mark up legislation (S. 353) that would make it easier to remove class action cases, including class action securities fraud claims, from State court to Federal court and could cap attorney's fees at a "reasonable percentage" of the financial benefits actually recovered by the members of the class. The legislation would permit the shift to Federal court if the defendant and at least one of the plaintiffs live in different States, as compared to the current law requirement that all of the defendants live in different States from all of the plaintiffs. The House already has passed similar legislation (H.R. 1875). However, the President has threatened to veto the legislation.

The legislation is intended to curtail perceived forum-shopping for "home court" advantage by plaintiffs in class actions, as well as to address a spate of

recent class action settlements in which plaintiffs' counsel received substantial fees, while class members were left with nominal benefits.

Plan Administration

During this period, we also have worked with STRS staff with respect to the drafting of the new Defined Benefit Supplemental program, as well as assisting with a variety of other plan administration issues.

John S. Stanton

June 19, 2000